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IN THE

Supreme Court of the United States

OCTOBER TERM, 1961.

No. 237.

HOUSEHOLD FINANCE CORPORATION,

Appellant,

vs.

DIRECTOR OF THE DIVISION OF TAXATION, DEPARTMENT OF THE TREASURY OF THE STATE OF NEW JERSEY,

Respondent.

ON APPEAL FROM THE SUPREME COURT OF NEW JERSEY.

APPELLANT'S BRIEF OPPOSING RESPONDENT'S MOTION TO DISMISS AND APPELLANT'S APPENDIX F.

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August 28, 1962.

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APPELLANT'S BRIEF OPPOSING RESPONDENT'S MOTION TO DISMISS.

Introduction.

On the basis of the jurisdictional statement and respondent's brief, the primary question on this appeal is how to measure the "total business of the taxpayer" against which the taxpayer's business local to New Jersey is to be compared. A related question is whether the fact that an excise tax is involved entitles the State of New Jersey to tax extraterritorial values.

. . . . . .

The court below stated (Appellant's Appendix A, p. 6a):

> "* * * it is reasonable to assume the franchise to do business in this state contributes to the net worth in the proportion that the business done here bears to the total business of the taxpayer."

The statute provides (Respondent's Brief, p. 10) that this allocation shall be on the basis of

> "the taxpayer's gross receipts arising from its New Jersey business divided by its gross receipts arising from its business done everywhere."

The statute defines gross receipts in detail, but it does not specify the *business* from which the significant gross receipts flow. Also, it does not provide alternative methods of allocation for franchise values which are simply not measurable in terms of gross receipts. In this appeal the central question is how to select or define "the total business of the taxpayer" against which to compare the local business consistently with due process.

Upon the facts of this case, three different types of gross receipts problems are involved:

(1) Both in the numerator and in the denominator there are gross receipts from customers of appellant who do business with it in the offices which it owns directly.

(2) In the denominator there are dividends, interest, and supervision fees from appellant's Canadian subsidiaries and interest and supervision fees from its U. S. subsidiaries which are not comparable to receipts from customers of the parent and which the court below stated were less in each case than the gross receipts from the customers of these subsidiaries. When compared to the gross receipts from appellant's New Jersey customers which make up the numerator, these reduced gross receipts from appellant's out-of-state subsidiaries exert an arbi-

trarily reduced weight in the denominator of the gross receipts fraction. This increased the fraction and operated to subject extraterritorial values to the New Jersey franchise tax.

(3) In the total net worth to be allocated, there are out-of-state headquarters assets which directly produced virtually no gross receipts which could reflect their contribution to appellant's business (*a fortiori* the geographical distribution thereof) in the denominator of the gross receipts fraction. The gross aggregate value of these headquarters assets ranged from $21,000,000 to $24,000,000 for the four years under review and included both tangible and intangible property. The statute does not contain a property fraction and therefore makes no provision for dealing with the contribution to a business of assets used in and necessary to the business but from which no income is immediately derived and which, therefore, are not measurable and distributable in terms of gross receipts.

The foregoing disparities in respondent's method for measuring the various segments of appellant's out-of-state business and the portions of net worth represented by them distort the allocation formula so as to allocate substantial extraterritorial business or values to New Jersey.

Does the foregoing method of allocation for franchise tax purposes violate the 14th Amendment of the Federal Constitution in that it subjects extraterritorial business or values to the New Jersey franchise tax?

ARGUMENT.

I.

Can respondent subject extraterritorial business or values to its franchise tax?

A principal area of dispute concerns whether respondent can tax extraterritorial business or values under a franchise tax which it could not subject to a property tax. To support its position respondent quotes from the history of the legislation under which the tax is asserted (Respondent's Brief, pp. 14-17). That quotation includes the following:

> "The selection of a method of allocation depends upon the type of tax with which it will be used. If the proposed tax were deemed to be a property tax, the matter of allocation would be reduced to the simple proposition that the state may constitutionally tax only such property as may be found within the State. * * * Foreign corporations could be subject to a measure *including only that portion of their capital employed within the state.*
>
> "*Under an excise tax measured by capital, as proposed, there is considerably more freedom* to achieve a working equality of treatment as among the various classes of taxpayers, foreign and domestic corporations and unincorporated business. * * *". (Respondent's Brief, pp. 14-15, emphasis supplied)

The issue here presented arises under the due process and equal protection clauses of the 14th Amendment. As Professor Hartman put it in his article "State Taxation of Interstate Commerce: A Survey and Appraisal," 46 Va. Law Review 1051, 1059 (1960):

> "The restraining power of the due process clause, it might be said, keeps the taxing power at home. It prevents a State from fixing its tax talons on extraterritorial values."

This Court in *Central R. Co. of Pa.* v. *Pennsylvania*, U. S. , 8 L. Ed. 2d 720, 82 S. Ct. (decided June 25, 1962) recognized that assets should not be subject to property taxes in two jurisdictions and that the domiciliary state loses jurisdiction to tax property to the extent that it has acquired a property tax situs in a different jurisdiction. However, until proof of a non-domiciliary situs with tax potential has been provided, the domiciliary state retains the jurisdiction to tax.

Here the domiciliary state is Illinois. Included in appellant's net worth is a net value reflecting from $21,000,000 to $24,000,000 of headquarters assets, depending upon the year involved, plus the net value of appellant's investments in its subsidiaries. Under respondent's gross receipts formula the headquarters assets were given no weight and appellant's investments in its subsidiaries were given less weight (relative to appellant's assets in New Jersey) in terms of their respective contribution to appellant's business than the facts warrant. This has resulted in subjecting extraterritorial values to the New Jersey franchise tax. See *infra*, p. 10.

Respondent argues that *Ford Motor Co.* v. *Beauchamp*, decided in 1939 (Respondent's Brief, pp. 11-12; cf. Jurisdictional Statement, pp. 16-17), holds that all gross receipts allocation formulas, when used to measure excise taxes upon franchises, are valid. Respondent seems to argue further that in *Beauchamp* this Court foreclosed the taking of evidence concerning whether, in computing the weight to be given local assets in business use solely by gross

receipts apportionment, the formula results in a particular case in the taxation of extraterritorial franchises.

The crux of what this Court said in the *Beauchamp* case appears to lie in the following sentence quoted by respondent (Respondent's Brief, pp. 12-13):

> "The weight, in determining the value of the intrastate privilege, given the property beyond the state boundaries is but a recognition of the very real effect its existence has upon the value of the privilege granted within the taxing state."

This appears to be merely another way of stating what this Court said in the *franchise tax* case of *Wallace* v. *Hines*, 253 U. S. 66, 64 L. ed. 782, 40 S. Ct. 435 (1920):

> "The only reason for allowing a state to look beyond its own borders * * * is that it may get the true value of the things within it * * * ."

In the *Beauchamp* case this Court did not discuss what weight should be given to the property located outside the taxing state's boundaries in arriving at the franchise value to be taxed within the state. Specifically, *Beauchamp* was solely concerned with the resulting value taxed in comparison to the assets in Texas when valued alone, rather than with the method used to arrive at that taxable value.

Here the issue involves the validity of the method used to arrive at a value taxable in New Jersey. Does the dissimilarity in the character of the gross receipts used to measure business done within New Jersey as contrasted with the gross receipts used to measure "the total business" done everywhere violate due process? This lack of similarity has demonstrably subjected to the New Jersey tax a portion of total net worth value reasonably attributable to assets and business outside the state and therefore not reasonably attributable to New Jersey or subject to its

taxing powers. See *infra*, p. 10. Very recently this Court in effect reaffirmed the doctrine that due process precludes state taxes on extra-territorial values or transactions. It did so by invalidating a state tax measured by the premium cost of insurance contracts made outside the state where the only contact with the state was that the property insured was physically located there. *State Board of Taxation* v. *Todd Shipyards Corp.*, U. S. , 8 L. ed. 2d 620, S. Ct. (decided June 25, 1962). Appellant argues that an apportionment formula is not valid if it can be demonstrated that it results in the taxation of extraterritorial value whether the tax be a property tax as under *Central R. Co.* v. *Pennsylvania, supra*, or an excise tax, as here.

II.

There are defects inherent in a gross receipts formula as a measure of appellant's taxable net worth.

Respondent stated (Respondent's Brief, p. 22):

> "More significantly, close scrutiny of Appellant's position discloses that it did not below nor does it before this Court seek to establish a tax base upon a truly 'consolidated' position."

This statement is correct. Appellant does not advocate any form of gross receipts fraction as the last word in allocation. Even a consolidated gross receipts fraction fails to give any value to non-income-producing assets necessary to the conduct of a business.

No effective method to value appellant's non-income-producing headquarters assets under a gross receipts formula has been devised, with the result that their value has not been taken into account at all by respondent Respondent

seeks to project the use of headquarters assets into states where the branch offices operate, claiming that their only measurable contribution to value is to produce gross receipts indirectly in connection with local branch-office operations (*ibid*, pp. 3, 4, 7, 17-18, 30). Respondent excludes altogether (as necessarily also does the statute) appellant's non-revenue-producing business of owning, protecting and managing these assets where located. Consistently with this argument, the New Jersey Supreme Court observed that "the location of headquarters was of no moment. . . ." (Appellant's Appendix A, p. 6a).

Moreover, when respondent used gross receipts from appellant's customers in New Jersey to measure the net worth of appellant's New Jersey business, it also should use gross receipts from the subsidiaries' customers in the denominator if the values attributable to these two types of business are to be at all comparable. Appellant's subsidiaries are engaged in the same business as is appellant. They contribute to appellant's total business in relation to their gross receipts from customers to the same extent as do appellant's directly owned offices. It is significant that respondent does not seriously contend that appellant is merely in the business of managing and enjoying a portfolio of stocks and interest-bearing loans. On the contrary, respondent asserts that appellant conducts its small loan finance business and its Canadian operations "through subsidiary corporations" (Respondent's Brief, pp. 2, 3) and makes advances to its subsidiaries "for the purpose of providing these subsidiaries with funds for loans to the general public" (*ibid.*, p. 3). Nevertheless, only dividends, interest and supervision fees representing a fraction of the true receipts of that part of the business done by the subsidiaries are included by respondent in the "total business" against which "local business" is compared.

III.

Respondent misinterpreted appellant's expert witness.

The respondent's brief, at page 21, states:

> "In fact, the testimony of its own expert demonstrates that the New Jersey apportionment formula, while not perfect, was not unreasonable."

This statement was footnoted with the following:

> "'Q. What, then, is your opinion as to the appropriateness and reasonable accuracy from an accountancy standpoint of the 6 apportionment methods? A. Well, I think each method would produce reasonable accurate results. None of them are perfect. Each has some defects, but they all bear some relationship to the contribution of net worth of each individual segment of business of the corporation * * *' (Resp. App. B, 7a) Included in the '6 apportionment methods' is the statutory apportionment based upon the 'unconsolidated' receipts of appellant."

The first sentence quoted above and the concluding sentence in the foregoing footnote are inaccurate.

Appendix F hereto contains a more complete excerpt from the testimony of the witness quoted in respondent's brief. The witness testified concerning six formulas developed by him. Four of these appeared in appellant's trial exhibit known as Annex 12, which respondent reproduced as Appendix D of its brief in this Court. Two more were developed orally. Seemingly there is no dispute that this testimony related to six formulas which the witness was discussing when the above statement was made. Respondent's error is in stating that respondent's gross receipts

formula was one of these six. The testimony quoted above and in respondent's footnote does not deal with respondent's gross receipts formula except as the results of the six formulas he was discussing demonstrate the inadequacy of the State's formula. See especially Appendix F, pp. 52a-53a.

The expert witness's testimony concerning the State's gross receipts apportionment formula is that it is not valid for reasons set forth in the footnote at page 12 of appellant's Jurisdictional Statement.

IV.

The evidence shows that the State's formula resulted in the taxation of extraterritorial value.

In point II as well as point III of respondent's Brief, the Attorney General argues that appellant has not established the taxation of extraterritorial values by "clear and cogent" evidence and refers to Respondent's Appendices B, C, and D.

The figures in respondent's Appendix D are inaccurate as will be demonstrated later, *infra*, p. 12.

Appendix B includes a copy of Annex 12 to the Statement of Facts and is correct. Appendix C is taken from Appellant's main brief in the court below and is correct. The figures in these two exhibits together with the testimony of appellant's expert in respect to them (Appellant's Appendix D) constitute a broad summary of appellant's evidence of the taxation of extraterritorial value. Appellant contends that the evidence so summarized does constitute "clear and cogent" evidence of the taxation of extraterritorial values.

Respondent's Appendix C shows that, computed by the average of six different realistic methods (all supported by uncontradicted expert testimony) only 3.59% of total net worth value would be attributable to New Jersey for the tax year 1955, e.g.; but that the State's formula actually increased New Jersey's tax base by 31.38%, or 4.72% of total net worth value.

Out of a regard for brevity appellant did not include in the Appendices to its Jurisdictional Statement any reference to the above six formulas. However, taken with the testimony of appellant's expert witness (Appellant's Appendix F), they demonstrate that the contrast between the results of six realistic methods of allocation on the one hand and the results of respondent's method of allocation on the other hand clearly establishes that under respondent's method extraterritorial values are being subjected to the New Jersey tax.

That percentage increase represents for 1955 a realistic estimate of the amount of total net worth attributed to New Jersey by the State's formula but which actually was outside its territorial jurisdiction and subject to the taxing powers of other states.

An apportionment formula is not reasonable which contains the defects described by appellant's witness as quoted on page 12 of our Jurisdictional Statement, and which by reason of those defects overstates the tax base by one-third.

The data in Annex 12 attached to the Motion to Dismiss shows that for the other years in question the State's formula is similarly out of line with reality and similarly taxes extraterritorial values.

V.

Respondent's Appendix D is misleading and inaccurate.

The figures in respondent's Appendix D were not compiled by appellant. The footnote to the Appendix indicates that the figures are "derived from" appellant's figures in Annex 12 and its brief filed below.

In "deriving" the figures in the "everywhere" lines on that Appendix the respondent has subtracted from the consolidated figures appearing in the record below the entire amounts applicable to subsidiaries. Seemingly he did this to produce the figures in the "everywhere" lines which he calls (page 8) "unconsolidated assets, loan accounts and net operating income".

But after deducting from consolidated figures the items relating to the subsidiaries respondent should have *added back the intercompany items which had been eliminated in computing the consolidated figures.* The "everywhere" line, for example, under "assets" does not include *any* value for the investment in subsidiaries either consolidated or unconsolidated. The total assets of appellant as adjusted by the respondent himself in his redetermination for 1954, e.g., were $384,029,000 instead of only $267,743,000 as he now argues to this Court in his Appendix D.

Appellant's evidence establishes by "clear and cogent evidence" the taxation of extraterritorial values. Such evidence deserves to be discussed at greater length than is appropriate here.

VI.

The injury is not *de minimis*.

Respondent argues that the differences between the results under various formulas discussed in the record and the results under the State's formula were *de minimis*. (Respondent's Brief, pp. 27, 30.) For instance, the statement appears at page 27:

> "The average New Jersey percentage for all of the tax years involved based upon unconsolidated gross receipts was 4.58%. The average percentage for all the years involved based upon consolidated gross receipts was 3.54%, a difference of only 1.04%."

This is mathematical sleight of hand. 4.58% is 29.27% greater than 3.54%. Such a difference is not *de minimis*.

VII.

Public benefit will result from a decision of this appeal by this Court.

There is a public need to have this area of the law reviewed. Clarificaton of state power to tax multi-state businesses has long been needed. Uncertainty in these areas has been so vexatious that: "This Court alone has handed down some three-hundred full-dress opinions * * *" *Northwestern-States Portland Cement Co.* v. *Minnesota*, 358 U. S. 450, 457, 3 L. ed. 2d 421, 427, 79 S. Ct. 357 (1959). The ever-rising state tax rates and the increasing complexity and territorial expansion of business, all testify to the vital need today for a clearer definition of state powers in these critical areas.

The greatest opportunity ever offered to systemitize state taxation through Congressional legislation is today knocking at the door. Justices of this Court have on several occasions in recent decades urged Congress to make a survey of state taxation of multi-state businesses in the light of national needs and to prevent distortions in such taxation by establishing systematic integrated rules. See, e.g., *McCarroll* v. *Dixie Greyhound Lines, Inc.*, 309 U. S. 176, 189, 84 L. ed. 683, 60 S. Ct. 504 (1940, Black, Frankfurter and Douglas JJ.); *Northwest Airlines, Inc.* v. *Minnesota*, 322 U. S. 292, 88 L. ed. 1283, 64 S. Ct. 950 (1944, Black J., at 302; Jackson, J. at 306, 307); and *Northwestern States Portland Cement Co.* v. *Minnesota, supra*, (Frankfurter, J. at 476, 477). For such purposes, the due process clause seems peculiarly well fitted. Congress and the public have begun to move in this direction.

The enactment of Public Law 86-272 as amended (73 Stat. 555, 15 U. S. C. A. Section 381 et seq. (1959); 75 Stat. 41, 15 U. S. C. A. Section 381 n. (1961); and P. L. 87-435 (1962)) has, for the first time since the adoption of the Constitution, established certain rules for state imposition of taxes on, or measured by, net income derived from interstate commerce. This law also provides for a study by designated Congressional committees, which are to make their reports of such studies on or before July 1, 1963. A Special Subcommittee on State Taxation of Interstate Commerce has been organized within the House Committee on the Judiciary, has entered upon its studies, and has held hearings (hearings, 87th Cong., First Sess., ser. 14, held December, 1961); the most recent hearings in June, 1962, either have not yet been published or have not been made generally available in published form. The strong support for Congressional action is evidenced by the cited report of the

December, 1961, hearings and by numerous law review articles and other publications. Illustrative of this material, are the following, inspired by Public Law 86-272 and devoted entirely to state taxation problems: "Developments in the Law—Federal Limitations On State Taxation of Interstate Business," 75 Harvard Law Review 953 (1962); A Complete Issue of the Virginia Law Review, 46 Va. L. Rev. 1051 (1960); and the work prepared by the Committee on State and Local Taxes, Section of Taxation, American Bar Association, "A Compilation of Views Divergent and Otherwise on Current Important Problems in State and Local Taxation of Multi-State Businesses" (1962). This last named publication digests the diverse views held unofficially, by the Committee members (made up of men having a most diverse variety of experience) and others on the wisdom and nature of a federal statute to govern state taxation under the Federal Constitution. The present outlook for constructive legislation is most encouraging.

There are several unresolved constitutional problems in the state taxation of multi-state businesses which are currently important. Their authoritative resolution by this Court would give Congress guidance needed in the enactment of a comprehensive integrated statute to regulate state taxation. And, even if there is no further legislation by Congress, the clarification of these problems would be of substantial value to state legislative and judicial bodies, and to many taxpayers, including the appellant, which are faced with these problems under a variety of tax impositions.

The common thread running through the various facets of these and other questions is the problem of apportionment to avoid extraterritorial taxation.

Taxation without representation has been condemned since the time of our founding fathers. More recently in *McGoldrick* v. *Berwind-White Coal Mining Co.*, 309 U. S. 33, 44; 84 L. Ed. 565, 570 (1940) this Court warned of:

> "* * * the recognized danger that, to the extent that the burden falls on the economic interest without the state, it is not likely to be alleviated by those political restraints which are normally exerted on legislation where it affects adversely interests within the state."

Conclusion.

Here the respondent seeks to impose an excise tax on extraterritorial values which it clearly could not have imposed if the tax were a property tax. There is a need to review this area of the law. It is respectfully submitted that the respondent's motion to dismiss should be denied and that this Court should note probable jurisdiction of this appeal.

Respectfully submitted,

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Dated: August 28, 1962.

Appellant's Appendix F.

Excerpts from Transcript of Proceedings before Division of Tax Appeals, pp. 74-92 Seriatim.

[Appellant's Witness R. Bradner Mead is being examined by Appellant's attorney, Mr. Ward. Mr. Brochin is attorney for Respondent.]

Q. I refer you to Annex 12. There are five major columns on Annex 12, Mr. Mead, each broken down into two subcolumns. Will you explain in order the significance of each of those five columns? (75) A. Well, each of them takes the total net worth as determined by the Commissioner.

Q. What is that figure, for the record? A. For the first year, for tax year '54, it is $124,731,816.

Q. We will use that as an example. A. Then, in Column A, it distributes it amongst the various components of the corporation's business on the basis which the Commissioner used, which was the gross receipts of the taxpayer. Column 1 under A shows the percentage of gross receipts which were received from each component of the business and, multiplying each of those percentages by the 124,000,000, gives the portion of net worth that the Commissioner in effect allocated to each division of the business.

Then Column B shows the same kind of a distribution, using, instead of gross receipts, the assets of the taxpayer that were employed in each different component of the business.

. . . . . .

Q. Column C, what is that? A. Column C is following the same pattern, based on the consolidated assets of the corporation and its subsidiaries.

Q. Column D. A. Column D is based on the consolidated receipts of the taxpayer and its subsidiaries.

Q. What receipts are those, not in dollars, but describe (77) them; what are they? A. Going down the line, the receipts of subsidiaries are the total interest received from customers to whom they have lent money.

The receipts of the headquarters are miscellaneous receipts mentioned previously.

Appellant's Appendix F.

The receipts of HFC branches outside of New Jersey and in New Jersey are receipts of interest from customers to whom they have lent money.

Q. Column E? A. Column E takes the total net income of the consolidation and breaks it down again between the various components of the business, consolidated net operating income, again, which was defined to be the income before interest paid, Federal income taxes and non-operating items.

Q. Are you familiar with the summary figures pertaining to consolidated payroll of the taxpayer and its subs? A. Yes.

Q. Have you prepared a percentage relationship between the consolidated payroll of New Jersey branch office businesses and the total consolidated business of the taxpayer and subs? A. Yes.

(78) Q. What is that percentage?

. . . . . .

Q. Then there was an objection and a request to see the (79) document. For the year 1954, Mr. Mead, what is the percentage relationship between New Jersey branch payroll, Household, and consolidated payroll.

Mr. Brochin: Objection. Before you answer, please, I object to the question now on the ground that the answer which it calls for is not material or relevant to the issues here.

Mr. Ward: As to that, of course, your Honor, I am building up to a still further available allocation method, all directed to show how completely unreasonable and out of line with reality the Director's method is.

The Commissioner: Let me ask you this: as an ultimate conclusion in your case, do you propose to show the Division how the tax should have been computed?

Mr. Ward: Yes, sir, I will accept that.

The Commissioner: I am not suggesting anything. I am asking is that what you are going to do, is that your method, part of your method of showing the Division that this tax is wrong and what the tax should be?

(80) Mr. Ward: Let me elaborate, your Honor. We contend that the statute as literally written permits of enough discretion in the Director to achieve a constitutional, fair and just apportionment of this business. That is our statutory argument. We contend, of course, that his result was not either constitutional, fair, just or related to business realities.

If, however, it is ultimately determined that his method of apportionment was in literal compliance with the statute, then, as part of our constitutional argument, we are entitled to show that the method used was so far out of line with reality as compared to every other known and reasonable method of allocation, that it must be set aside as unconstitutional.

Consequently, any recognized and reasonable apportionment that we can adduce can be used either to show the Director how he should have interpreted the statute or, if the statute simply won't stretch that far, to show that the statute was unconstitutional.

The Commissioner: Well, let me suggest this to you——

Mr. Ward: And, of course, I mean with application to this particular case.

(81) The Commissioner: Let me suggest this to you: I am not certain at the moment, but it is my offhand understanding that the only judgment that the Division can make is a judgment which either sustains the Director or finds what the tax should have been. I don't think that the Division has the authority to say to the Director, "You did it wrong. Assuming that to be so, go back and do it over." In other words, I don't know that this Division has the

authority to remand, and therefore it would seem to me that, as a part of your case, you ought to be prepared to say what you think the tax should have been and how it should have been computed.

Mr. Ward: Actually, our petition prays that the tax as we reported it be reinstituted and accepted as the proper one.

The Commissioner: I thought that that might be the answer, that that may be what your contention is, and thus I can find some grounds on which to rule on the objections which are being made. In other words, it is very difficult at this point to see whether or not figures have any bearing, any figures have any bearing. Maybe the figures are not important (82) to me when I get done with the thing. Maybe it is just a matter of passing upon a formula. I don't know that, but if you tell me, I ask you and you say to me that what you are offering in evidence now forms part of your computation of the tax, or formed part of the computation of the tax that the Director levied, then I certainly find that whatever you are offering is admissible. If it doesn't, then I certainly need some explanation of why it is admissible.

Mr. Ward: Your Honor, we have set forth in Annex 12, four available methods of allocation. I am now developing a fifth, and I have a sixth up my sleeve. I don't say, your Honor, that an average of all six of them or any three or four of them should be taken. To that extent, they do not represent part of our tax computation. However, they do support the tax computation which we actually made in our return, which we are contending should be your judgment. They support it by the fashion of showing that it was a reasonable one, one with economic and business reality, which is ultimately what the statute requires. They are illustrative, if

you will; nevertheless, they are relevant for that purpose.

. . . . . .

Q. Did you, Mr. Mead, state what that relationship [of payroll] was for the year 1954, tax year? A. 3.27%.

Q. For the year 1955? A. 3.20%.

Q. '56? A. 2.96%.

Q. For 1957? A. 2.65%.

Q. Let me refer you back, please, to Annex No. 10, which is the so-called gross rates of return on loan account. Is it possible to relate the New Jersey Household Finance average loan account shown in Item No. 2 for each of the four years to the total consolidated average loan account shown in Item No. 3 for each of the four years? A. Yes.

Q. Have you done that computation? A. Yes.

(84) Q. What are your percentages? A. Tax year——

Mr. Brochin: Would you read back those questions?

(The last three questions and answers were read back by the Reporter.)

Q. For 1954 tax year, please. A. 4.03%.

Q. '55? A. 3.75%.

Q. '56? A. 3.31%.

Q. '57? A. 2.91%.

. . . . . .

Q. Mr. Mead, the four computations shown in columns B through E, and in the material you have just given us as (85) to consolidated payroll and loan account, what are those computations, speaking now as an accountant? A. Well, each is an attempt to take the total net worth of the corporation, which we have determined to be the same in each case, and spread it amongst the various components of the business on some equitable basis.

Q. As a Certified Public Accountant with long experience in financial business, do you have an opinion as to the

appropriateness and reasonable accurateness from an accountancy standpoint of the six apportionment methods you just described? A. Yes.

Mr. Brochin: Objection.

The Commissioner: Is this on Annex 12?

Mr. Ward: Referring to the four on Annex 12 plus the other two he stated being payroll and loan account percentages.

Mr. Brochin: If I may amplify my objection, your Honor, whether this witness thinks that the particular methods which he proposes would be fair and equitable means of apportionment, it seems to me, is completely irrelevant and immaterial.

(86) Mr. Ward: Of course, your Honor, I asked him to qualify his opinion as being from an accountancy standpoint. I am not eliciting a legal opinion from him now.

I think if Mr. Brochin questions his qualifications to hold such an opinion, he can find out about that on cross examination, but I am sure I have laid enough basis for this man, who is a highly-trained accountant, familiar with financial businesses, more than anybody else in the room, laid the basis for him to say whether or not any or all of those methods of apportionment are appropriate from an accountancy standpoint to the job that we have at hand.

The Commissioner: I think we will admit it. I think your objection goes to the weight rather than the admissibility, and we will admit it.

Q. What, then, is your opinion as to the appropriateness and reasonable accuracy from an accountancy standpoint of the six apportionment methods? A. Well, I think each method would produce reasonably accurate results. None of them are perfect. Each has some defects, but they all bear some relationship to the contribution to net worth of each individual segment of (87) the business of the corporation. Take, as an example, consolidated assets. Assets.

Q. Let me interrupt. Are you referring to column C of Annex 12? A. Yes, column C. Certainly assets contribute to net worth, one of the basic contributions to net worth, and spreading the net worth amongst the various components of the business on the basis of the assets would be a valid spread. The assets of each portion of the business are quite comparable in type to the assets of other portions of the business. Similarly with salaries, the other thing that contributes to the value of a business besides the assets of the business is the work done by the people who are working for the business, and the salaries of the people working for the business to some extent are certainly a measure of the contribution to the net worth of that segment of the business, and again the people employed in the different segments of the business, the salaries of them is a comparable item, comparing one segment of the business to another segment.

Q. I notice that in column D the consolidated receipts technique, and in column E the consolidated net operating technique, produces a zero value for headquarters' (88) property. Do you have an opinion as to the appropriateness of those two methods of apportionment in the light of that fact? A. Yes. As I said, each method has some defect. The defect of those two methods is, and also the sixth method, the consolidated loans outstanding method, is that they do not give any effect to the contribution by the headquarters, located wherever it may be located.

Q. Do you have an opinion, on the same basis as my original question about opinion, as to the appropriateness and reasonable accuracy of the method of apportionment which you have told us is reflected in column A of Annex 12? A. Yes.

Q. What is that opinion? A. My opinion is that it is not a valid method of apportionment. It creates a great distortion because, while it is based on gross receipts, the gross receipts of the different components of the business are not the same types of gross receipts, plus the added factor that, the same as in the three methods we just dis-

cussed, it gives no effect or practically no effect to the contribution of headquarters. And, to elaborate on those gross receipts, the gross receipts of the component of (89) the business, that is branches outside of New Jersey and also that of the branches in New Jersey, is the money that the branches have taken in from customers to whom they have lent money.

The gross receipts of Household Finance Corporation, the taxpayer, from the component of its business, that is investment in subsidiaries, is simply whatever dividends they may happen to pay to the parent company and whatever interest they pay on money borrowed from the parent company.

Looking beyond the parent company to the gross receipts of the subsidiaries' portion of the business that would be comparable to the gross receipts of the branch business in New Jersey and outside of New Jersey it would be the actual gross receipts that those subsidiaries received from their customers, rather than simply the interest and dividends from the subs.

There are two defects in interest and dividends, one being they are in effect something less than the net profit of the subs, the other being that they can vary from year to year, according to how the subs happen to pay them to the parent, without regard to the actual net worth in that investment in subs during that year.

(90) Q. In your opinion, as I have previously stated on the same basis——

Mr. Brochin: And with the same objection.

Q. And with the same objection, is the spread variously between your six figures of 3.68% assets of the taxpayer, 3.59% consolidated assets, 4.05% consolidated receipts, 4.11% consolidated net operating income, 3.27 payroll and 4.03 loan account percentage an acceptable spread from an accountancy standpoint for the purpose of reflecting true division of adjusted net income? A. I

would say so. They are all fairly close together, and we have already mentioned the reasons why some of them differ from others.

* * * * * *

Q. Mr. Mead, you described this morning six alternate methods of apportionment. Were any of the methods you described this morning the ones which petitioner actually used on its returns? A. No.

Q. Will you describe for us, please, the methods which petitioner actually did use on its returns? A. We used two different methods amongst the six. First of all, we took the total net worth, and we excluded from that a portion attributable to the investment in subsidiaries. We did that on an asset basis. We took a fraction, of which the numerator was the asset investment in stock of and advances to subsidiaries. The denominator was total assets. Then that fraction was applied to the total net worth, to determine the portion of net worth attributable to investment and subsidiaries.

The remainder of net worth was allocated to New (92) Jersey and conversely to outside New Jersey on gross receipts fraction, excluding from gross receipts any gross receipts from the subsidiaries, since they had already been pulled out of the net worth.

Q. In your opinion, on the same basis as your opinion evidence of this morning, is that method of allocation an appropriate and reasonably accurate method of apportioning the net worth of a financial business? A. Yes.

Mr. Brochin: Would you read the question?

(The question was read by the Reporter.)

Mr. Brochin: Objection, your Honor.

The Commissioner: Overruled.

Q. Is it consistent from an accountancy standpoint with the other methods you described to us this morning? A. Yes.

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